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C O N F I D E N T I A L SECTION 01 OF 05 RIYADH 001642

SIPDIS

DOE FOR DEPUTY SECRETARY PONEMAN, PDAS JOHN ELKIND
DEPARTMENT FOR NEA/ARP
DEPARTMENT FOR CIEA GOLDWYN

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SUBJECT: DEPUTY ENERGY SECRETARY PONEMAN BROADENS U.S. -
SAUDI ENERGY COOPERATION

REF: RIYADH 1557

Classified By: Charge d'Affaires Susan L. Ziadeh, reasons 1.4 (b and d)

¶1. (C) Summary: Deputy Secretary of Energy Daniel Poneman led an interagency team to Saudi Arabia on December 6-8 to discuss a range of energy issues, including potential areas for renewing our bilateral partnership. Saudi officials warmly welcomed the visit. Petroleum Minister Al-Naimi outlined the Kingdom's current oil production plans, which he does not expect will require significant new production capacity for several more years. Saudi Arabia is concerned about the long-term prospects for oil demand, as it is watching OECD demand decline in favor of Asia. Al-Naimi explained that Saudi Arabia is focused on diversifying its economy to assure its long-term prosperity. He welcomed the prospect of cooperation on renewable energy, particularly solar. Saudi electricity officials outlined plans to manage rapidly growing domestic demand, including plans to attract private investment, particularly in renewable energy. Saudi Arabia is also considering the possibility of developing up to three nuclear plants. Al-Naimi strongly encouraged Energy Secretary Chu to visit early in the new year, and welcomed news that the U.S. will provide an additional \$141,000 to support the Experts Group of the International Energy Forum (IEF). End Summary.

¶2. (U) Deputy Secretary of Energy Poneman led an interagency delegation to Dhahran and Riyadh on December 6-8 to discuss areas of potential bilateral cooperation with Saudi officials, including Minister of Petroleum and Mineral Resources Ali Al-Naimi, Aramco CEO Khalid Al-Falih, King Abdulaziz City for Science and Technology President Mohammed Al-Suwaiyel and the acting governor of the Electricity and Cogeneration Regulatory Authority, Dr. Saleh Al-Bakhrebah. Saudi officials warmly welcomed the Deputy Secretary and his delegation, which included David Goldwyn, the Secretary of State's Coordinator for International Energy Issues, Jonathan Elkind, DOE PDAS for Policy and International Affairs, Bill Bryan, DOE DAS for Electricity and Infrastructure Protection, Rachel Walsh, NSC Director for Energy, George Person, DOE Director of the Office of African and Middle Eastern Affairs, Linda Specht, Deputy Director of the State Department's Office of Arabian Peninsula Affairs, and James Hart, Deputy Director of DOE's Office of African and Middle Eastern Affairs.

A Renewed Energy Partnership:
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¶3. (C) Deputy Secretary Poneman told Petroleum Minister Ali Al-Naimi that the United States is committed to expanding our

strong bilateral relationship into new, stronger directions in four areas. First, we seek to expand our partnership on oil and gas issues. He stressed that efforts to address climate change are not at odds with Saudi Arabia's development of its oil and gas resources, as the world will need oil for decades more. Second, we are interested in expanding our partnership on new technologies, including renewable, efficiency, CCS and nuclear power. In that regard, he applauded Saudi Arabia's participation in the Carbon Sequestration Leadership forum and welcomed its interest in solar energy. Third, the Deputy Secretary expressed strong interest in expanding cooperation on science and technology, including nanotechnology and basic research. Fourth, the Deputy Secretary accepted the Saudi suggestion to renew the U.S.-Saudi energy dialogue.

¶4. (C) Al-Naimi welcomed the Deputy Secretary's visit as the beginning of a renewed partnership, and agreed that there are a number of areas for cooperation. He also welcomed the acknowledgement that the United States knows it and other industrialized countries will depend on oil and gas for some time to come. Al-Naimi said that Saudi leaders tended to discard much of the rhetoric about shifting away from oil and gas, understanding that Saudi Arabia will continue to play an important role in meeting international energy demand. Al-Naimi noted there is considerable room for science and technology cooperation, and hopes that Secretary Chu will be able to visit King Abdullah University for Science and Technology (KAUST) when he comes early in 2010. He would like to show the Secretary KAUST's solar energy research center, which he has given the goal of producing 8 million

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barrels a day worth of electricity in the next decade. He confirmed Saudi Arabia's readiness to resume the U.S.-Saudi energy dialogue, and offered that Prince Abdulaziz bin Salman would follow up directly with Deputy Secretary Poneman and the Embassy.

Energy Security:

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¶5. (C) Al-Naimi noted that the Kingdom spends a lot of time worrying about energy security and reliability. Saudi Arabia has increased its production capacity from 8 to 12.5 million barrels a day, allowing for more than 4 million barrels of spare capacity at current rates of production. This spare capacity helps moderate the world oil market. Al-Naimi noted that a number of global pessimists had projected that world oil demand has peaked as long ago as 2005. Saudi Arabia continues to believe that the world will need more oil, and it is taking steps, including by increasing reserve recovery rates, to meet future demand. Saudi Arabia also plans to develop non-conventional oil resources, which will add significant reserves. Al-Naimi believes that the current capacity of 12.5 million barrels a day will be adequate for many more years. He said he would be surprised if Saudi Arabia is called on to produce more than 11 million barrels a day by 2020. He added that Saudi Arabia will continue to invest to replace declines in field production. Aramco CEO Khalid Al-Falih noted that Aramco has the industry's shortest timeline to bring new fields on line, at roughly half the average of international majors, which allows it to respond more quickly to any significant shifts in the world market. Al-Naimi thought that the current price of \$75-80 per barrel was about right to encourage investment, which would allow the development of conventional reserves and renewables/non-conventional (e.g., tar sands).

¶6. (C) Al-Naimi noted that Iraq has significant reserves, and that the government in Baghdad is trying to develop them, but expected security problems would limit production increases over the next five years. He noted that there is no lack of reserves in places like Iran, Kuwait, UAE. There is instead a lack of political will, as seen in Libya and other places

in Africa, to take the necessary steps to develop their economies.

Concerns About Saudi Prosperity:

17. (C) Over the long-term, Saudi Arabia expects demand for oil to fall. Al-Naimi noted that demand is already mainly in Asia, representing 70% of Saudi's sales, as OECD markets continue to decline. Al-Falih said that messaging from governments has an important effect on markets. It is harder to attract new investments today because of a lot of discussion about reduced demand. It is important to keep banks and companies interested, as the world still needs trillions of dollars of investments in refineries and exploration. Al-Naimi noted that Saudi Arabia is also making substantial investments in refining, not just inside the Kingdom, but also in the U.S., China, and Korea, including through joint ventures with companies like Total, Shell, Exxon and Conoco Phillips.

18. (C) Al-Naimi said that Saudi Arabia sees a threat to its long-term economic health from its dependence on fossil fuels. Diversification of its economic base is critical over the next decade. The most important part of that effort is education. In that regard, he said that the 24 government and 8 private universities, and the 400 colleges, are only a beginning of what Saudi Arabia needs. For this reason, the King had supported the development of KAUST, which will help Saudi Arabia achieve its vision of a diversified economic and industrial base. Saudi Arabia also needs help developing small and medium enterprises to support existing large companies. The Ministry of Petroleum will act as a catalyst for the development of other industries as part of the National Industrialization Strategy, which looks to maximize the value of Saudi Arabia's assets, including its extensive mineral and petrochemical resources.

IEF:

19. (C) Al-Naimi noted that Saudi Arabia has worked hard with the International Energy Forum to reduce volatility and

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Poneman hoped experts could sit down and agree on the best way forward for the future of the IEF. Deputy Secretary Poneman noted that keeping the IEF informal was likely to make it easier to find a way to secure a stable and predictable funding stream, and promised to look into possibilities for further U.S. support.

Fuel Subsidies:

110. (C) Al-Naimi said Saudi Arabia favors reducing fuel subsidies. Saudi Arabia is, however, a welfare society, and the government feels it must minimize the population's burden by supporting the costs of fuel and water. Instead of creating a political crisis by lifting fuel subsidies quickly, Al-Naimi said the government will look for ways to implement this gradually, while also expanding the economy and generating jobs. Al-Naimi concluded reducing subsidies is an issue of timing, as it makes no sense to sell one million BTU of gas for 75 cents. He noted that Saudi Arabia is also trying to support poor countries through the King's \$500 million proposed fund in the World Bank. Majed Al-Moneef, Saudi Arabia's OPEC governor, lamented that no other countries have yet responded.

Electricity Generation:

111. (C) Dr. Saleh Bakhrebah, the acting Governor of the Saudi Electricity and Cogeneration Regulatory Authority (ECRA), and his senior managers briefed the Deputy Secretary on the government's plans to develop the electricity sector. ECRA

has a 25 year plan, which forecasts that the demand for peak electricity will increase from the current 40 Gigawatts to 127 GW in 2032. The Saudi Electric Company (SEC) cannot meet all this demand itself; consequently, ECRA is working to create a system that will attract more private investment. ECRA has already licensed 11 private companies to generate electricity, including Aramco and the Jubail Electric Company. It would like to move beyond these examples, which generally serve particular industrial facilities, and attract private generation companies that will sell to the main grid.

ECRA understands that this will require a commercially attractive tariff. It has already introduced a graduated tariff for residential customers (ranging from 1.5 to 7 cents per 1000 kwh). Bakhrebah noted that the current tariff has not been raised since 2000, and that beneficiaries "fiercely resist" any increases. Bakhrebah said the government would have to make a tough political decision on how to balance the concern to protect consumers and provide for welfare on one hand, while also attracting investment on the other.

¶12. (C) ECRA is working to privatize the Saudi electricity generation sector in stages. It plans to set up an independent transmission company, regional distribution companies and service companies by the end of 2010. The first step will be to separate current generation facilities into four clusters, which will begin to compete. Similarly, ECRA will set up an initial national distribution company which will separate gradually into four regional divisions. ECRA is working with U.S. consultants to come up with a tariff system. The Council of Ministers recently provided ECRA with the authority to develop non-residential tariffs. Ultimately, ECRA wants to create a system in which consumers can buy their electricity directly from generators, which will have to compete on reliability and price, phasing in over time beginning with large consumers.

¶13. (C) Dr. Abdullah Al- Shehri, the Vice Governor for Regulatory Affairs, explained that Saudi Arabia is working on three areas to reduce demand. First, it is finalizing a policy to support renewable energy. On December 12, ECRA

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will review a consultant's report to set up a balancing fund to support renewables, particularly solar energy. Second, ECRA is installing digital meters, starting with large and new customers, which will allow ECRA to charge a higher tariff for peak demand (12 cents versus 3 cents per kwh for industrial customers). Al-Shehri said that many large industrial producers have the ability to control their peak demand, and can store electricity, but do not do so because they lack a commercial incentive. Third, ECRA is working with Japan on a National Energy Efficiency Program (NEEP) in coordination with KACST. Fully half of the peak electricity load comes from residential demand, of which half comes from air conditioning. ECRA's goal is to reduce this demand in a number of ways, including the application of a new building code this year, and by increasing the use of renewable energy, which happens to be most available in the case of solar during the peak demand time.

¶14. (C) Bakhrebah noted that ECRA is also trying to complete the national grid, including linking Riyadh and Jeddah. He also noted that the GCC interconnection has already proven valuable, as it prevented a grid crash in Qatar two months ago, when Bahrain and Kuwait were able to supply emergency power. The GCC grid will be officially inaugurated by heads of state in mid-December. Ultimately, Saudi Arabia is interested in expanding connections to Egypt, Jordan, Syria and Turkey.

¶15. (C) Deputy Secretary Poneman suggested that it would be useful to include in our bilateral energy dialogue efforts to manage demand, e.g., by installing smart grids and managing peak loads. Bakhrebah welcomed that suggestion, and noted that ECRA works with the University of Florida's electricity institute and the National Association of Regulatory Utility

Commissioners (NARUC).

Aramco Oil Production Overview:

¶16. (SBU) Aramco's Chief Petroleum Engineer provided an overview of the company's operations, noting that Saudi Arabia estimates it has approximately 742 billion barrels of oil, broken down into: 260 billion barrels of proven reserves; 346 billion barrels of probable reserves; and 116 billion barrels of produced oil. Aramco's current oil recovery averages roughly 50%, compared to the international average of 35%. Aramco expects to increase its reserves from 742 to 900 billion barrels over the next 20 years, and to increase its recovery rate from 50 to 70% through the application of new technology and processes, including the development of advanced new computing techniques and "smart" seawater injection programs. It is also expanding its use of techniques like geosteering to maximize the exposure of wells to the producing zones, drilling fewer wells with greater flow, and the development of real-time information from oil wells to maximize production efficiency. Aramco also plans to expand its gas capacity, which has doubled since 2000 to 16 billion standard cubic feet per day.

¶17. (SBU) The Chief Engineer stressed that Aramco develops fields to last 100 years, and is actively trying to improve its stewardship of the environment and natural resources. He noted that Aramco eliminated gas flaring 30 years ago, and stressed the importance of practical approaches to carbon management to support continued economic growth, while also reducing emissions. In this context, Aramco is developing a pilot Carbon Capture and Sequestration (CCS) project expected to come on line in 2013, and is also looking into using CO2 for enhanced oil recovery. These efforts have had a tangible impact on existing fields as well, extending the life of some fields beyond 60 years.

Nuclear Energy

¶18. (C) The Deputy Secretary inquired about Saudi views regarding nuclear energy development with KACST President Mohammed Al-Suwaiyel, who oversees KACST's Atomic Energy Research Institute. Al-Suwaiyel said nuclear energy would play a role in Saudi Arabia's efforts to meet its growing domestic energy demand, which is diverting increasing amounts of valuable oil and gas from the export market. The relevant Saudi ministries support holding a competitive international bid for nuclear power plants and are awaiting political approval to move ahead with the bid process, said

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Al-Suwaiyel. The Saudis will use International Atomic Energy Agency (IAEA) templates for the bid, which will include "one or two stations to start," and eventually up to three stations. France, South Korea, Japan, and Argentina have expressed interest in the development of Saudi Arabia's civil nuclear sector. Al-Suwaiyel said he did not think KACST should be the nuclear regulator once the sector develops, but said the Electricity and Co-generation Regulatory Authority (ECRA) was not qualified to regulate the nuclear sector, as it "has enough to worry about." (Note: The French Embassy separately reports that they had concluded a draft nuclear cooperation agreement, similar to our Section 123 agreement, with KACST in March. This agreement was sent to the Majlis al-Shoura, which questioned whether KACST is the right entity to manage Saudi Arabia's nuclear energy program, effectively stalling discussions. End Note)

¶20. (C) ECRA's Al-Shehri noted that the GCC had agreed to look into nuclear power in 2008, and that it would be easy to absorb a nuclear plant into the projected demand of 127 GW. He also noted that Saudi Arabia currently consumes 3 million barrels a day of oil equivalent (half in gas, half in fuel oil) to generate domestic electricity; in 25 years, this is

expected to increase to 8 mbd.

(U) DOE Deputy Secretary Poneman's office and S/CIEA Goldwyn
have cleared this cable.

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